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No. 95-554

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1995

ROBERT W. SCARTH, *et al.*,
Petitioners,

v.

NICOR EXPLORATION COMPANY,
Respondent.

On Petition For Writ Of Certiorari To
The United States Court Of Appeals
For The Fifth Circuit

PETITIONERS' REPLY MEMORANDUM

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LIST OF PARTIES

Pursuant to Rule 29(6) of the Rules of the Supreme Court of the United States, a list of the Petitioners in this case is provided in the Petition for Writ of Certiorari filed by Robert W. Scarth, *et al.*, on October 3, 1995 in these proceedings. Included therein is a description of the corporate affiliations of any corporate petitioners.

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*This regulation was removed from FERC's regulations. *Removal of Outdated Regulations Pertaining to the Sales of Natural Gas Production*, Order No. 567, III F.E.R.C. Stats. & Regs. (CCH) ¶ 30,999 (1994).

Pursuant to Rule 15.6 of the Supreme Court Rules, Petitioners, Robert W. Scarth, *et al.* ("Scarth"), respectfully reply to the Brief in Opposition filed by the Federal Energy Regulatory Commission ("FERC"), Respondent below, and to the Brief in Opposition filed by Respondent, NICOR Exploration Company ("NICOR")

I. FERC'S OPPOSITION IS MISLEADING AND DOES NOT PRESENT A VALID BASIS FOR DENIAL OF CERTIORARI

A. FERC claims that the application of *Chevron*[1] deference in this case is "no longer significant" because its jurisdiction over producer rates and contracts ended on January 1, 1993. Br. Opp. at 8. FERC's claim is, at best, misleading. This case does have important, continuing significance because FERC continues, as it did here, to regulate and interpret contracts under the Natural Gas Act ("NGA"). Thus, the split of circuits regarding the applicability of *Chevron* deference to FERC's interpretation of contracts under such statute should be resolved.

As FERC observed below, "[i]t is undisputed that under the NGA and the NGPA, jurisdiction to resolve contract disputes such as this one arising out of a regulatory scheme established by Congress resides, in the first instance, with the Commission." FERC 5th Cir. Br. at 19. FERC's NGA jurisdiction to review and interpret contracts stems from this Court's rulings in *Mobile-Sierra.*[2] These cases

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[1] *Chevron, U.S.A., Inc. v. NRDC*, 467 U.S. 837 (1984)

[2] *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956); *FPC v. Sierra Pac. Power Co.*, 350 U.S. 348 (1956).

hold that, unlike other types of regulatory statutes, a rate applicant under the NGA, such as Scarth, must have underlying contractual authority to collect the rates it proposes. Thus, under the NGA it is incumbent upon FERC to interpret a rate applicant's contract, as it did here, to ensure that there is contractual authority for the rate increase proposed. In turn, under *Chevron* as applied by the majority of circuits, FERC's contract interpretation is entitled to judicial deference.

Although, as FERC points out, producer gas sales have been decontrolled, FERC nevertheless still continues to regulate the rates of interstate gas pipelines under the NGA. Consequently, the issue of deference to FERC's contract interpretations under the NGA and *Mobile-Sierra* is a continuing issue of significance. The continuing nature of this issue is demonstrated by recent judicial deference rulings relative to FERC interpretations of pipeline contracts subsequent to producer decontrol.[3] In fact, even FERC acknowledges the continuing significance of this issue, noting that the Fifth Circuit *in the future* "may reconsider *and* reconcile its general approach *with the prevailing view* under *Chevron* . . . without the intervention of this Court." Br. Opp. at 10 (emphasis added). *See also id.* at 8-9 ("the Fifth Circuit's failure to afford deference to FERC . . . [here] appears to be in tension with the approach of other courts of

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[3]*See Northwest Pipeline Corp. v. FERC*, 61 F.3d 1479, 1486 (10th Cir. 1995). *Northwest* involved deference to FERC's interpretation of a pipeline tariff, which "are binding contracts." *See Coca-Cola Co. v. Atchison, T. & S.F. Ry.*, 608 F.2d, 213, 219 (5th Cir. 1979); *Williams Natural Gas Co. v. FERC*, 3 F.3d 1544, 1551 (D.C. Cir. 1993).

appeals with respect to FERC's interpretation of contracts in other settings.").

While thereby acknowledging that the Fifth Circuit's refusal to follow *Chevron* is erroneous, FERC nevertheless opposes certiorari. FERC knows that most circuits, including the critical D.C. Circuit where many FERC cases are brought, accord deference to FERC's contract interpretations. Apparently, FERC fears that the Court may review *Chevron* and possibly erode the deference now accorded to its contract interpretations by many circuits. However, this rationale does not provide a valid basis for denying certiorari. To the contrary, FERC's opposition only serves to encourage improper forum shopping, not only relative to future FERC contract interpretation cases, but also as to future contract interpretation actions by other administrative agencies. On the other hand, a grant of Scarth's petition will permit *Chevron* to be clarified so that the several circuits will not continue, as they do now, to apply disparate *Chevron* interpretations.

B. FERC claims that Scarth's assertion relative to the Fifth Circuits's failure to follow the substantial evidence standard affords no basis for review because that issue allegedly is "factbound." Br. Opp. at 10. However, the substantial evidence test is a rule of law, and it is the rule of law embodied in that test that the Fifth Circuit failed to apply. While *any* substantial evidence case involves "facts," the Fifth Circuit did not adhere to the requirement of law in the NGA that "[t]he finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive." 15 U.S.C. § 717r(b). This Court has granted

certiorari where, as here, the court below "misapprehended or grossly misapplied the substantial-evidence test." *Mobil Oil Corp. v. FPC*, 417 U.S. 283, 292 (1974).

C. FERC also maintains that the "correct application of Oklahoma law to the facts of this case" also is "factbound." Br. Opp. at 10. FERC misstates the issue presented in Scarth's Petition. Rather than the application of law to particular facts, the Petition instead presents the underlying basic issue that the Fifth Circuit *failed to apply the law of Oklahoma*. Notably, even FERC below told the Fifth Circuit that its orders' "reliance on contract interpretation standards . . . was consistent with . . . Oklahoma state law." FERC 5th Cir. Br. at 17.

D. FERC also contends that the Fifth Circuit's conflict with this Court's decisions concerning the scope of agency authority on remand is "factbound" and allegedly lacks practical significance because the court's decision "left FERC no option." Br. Opp. at 10. FERC's position is erroneous, as reflected by its statement *of law* that "courts normally must remand when they set aside agency decisions." *Id.* That the Fifth Circuit "left FERC no option" does not show a lack of practical significance. Instead, it shows that the Fifth Circuit's remand is in conflict with FERC's own acknowledged view of the law.

II. THE DEFERENCE ISSUE WAS RAISED AND ADDRESSED BELOW AND SCARTH IS NOT FORECLOSED FROM ARGUING THE ISSUE

NICOR argues that Scarth "never urged below" the deference argument based on *Chevron*, and that Scarth therefore is foreclosed from raising it here. Br. Opp. at 11. This simply is not true. The issue of deference was raised before the Fifth Circuit and addressed by that court. Therefore, the issue is properly before the Court.

In its brief to the Fifth Circuit, filed fifteen days before Scarth's brief, FERC clearly invoked the deference principle before the Fifth Circuit:

> The Commission's interpretation of the contracts at issue in this case is entitled to deference. . . . It is undisputed that under the NGA and the NGPA, jurisdiction to resolve contract disputes such as this one arising out of a regulatory scheme established by Congress resides, in the first instance, with the Commission . . . since it is the Commission which is intimately involved with establishing general standards for resolving such claims under Congress' statutory framework. Here, the Commission's contract interpretation was based on the specialized expertise that it applied in developing standards in Order 23 and Opinion 77 for use in resolving area rate clause disputes. Particularly with respect to the NGPA and its implementation, the Supreme Court has made it clear that "[w]e are neither inclined nor prepared to second-guess the agency's reasoned

determination in this complex area." *Mobil Exploration Co. v. United Distribution Co.*, 498 U.S. 211, 231 (1991).[4]

Consistent with Rule 28(i) of the Federal Rules of Appellate Procedure, Scarth in his Fifth Circuit brief stated he "concurs in FERC's position in its brief . . . that deference to FERC is appropriate in view of its specialized expertise," rather than repeating FERC's deference argument. Scarth Br. at 28, attached as the Appendix to NICOR Br. Opp. Thus, the issue of deference clearly was before the Fifth Circuit, as argued by both FERC and Scarth.[5] Moreover, the Fifth Circuit expressly addressed the deference issue, declaring that *de novo* review instead was appropriate. App. 10a.

III. SCARTH DID NOT CONCEDE THAT THE *DE NOVO* STANDARD OF REVIEW WAS APPROPRIATE

NICOR claims that Scarth below conceded that the *de novo* standard of review was appropriate. Br. Opp. at i. To the contrary, as noted above, Scarth in its Fifth Circuit brief

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[4]FERC 5th Cir. Br. at 19-20 (citation omitted). FERC there quoted a more recent *Chevron* deference case: "deference is particularly appropriate when, as here, the question of interpretation arises under 'a complex and highly technical regulatory program' entailing 'significant expertise, and * * * the exercise of judgment grounded in policy concerns'." *Id.* at 20, *quoting*, *Pauley v. BethEnergy Mines, Inc.*, 501 U.S. 608 (1991).

[5] Scarth also addressed *Chevron* deference in his Petition for Rehearing *En Banc*. *See* App. hereto.

adopted FERC's position that deference is required respecting FERC's interpretations of "area rate clauses" made pursuant to its delegated statutory powers and special expertise. In the language now quoted by NICOR, Scarth merely acknowledged that "[i]f contract interpretation were the only issue . . . *de novo* review might be the exclusive standard." Scarth 5th Cir. Br. at 27. However, contract interpretation was *not* the only issue, because the case also involved: (1) an agency interpretation of its enabling statutes (in Order 23 and Opinion 77, the bases of the orders below); (2) the application and interpretation of rules established to implement the agency's statutory duty (the Opinion 77 rules); and (3) the agency's exercise of its statutory duties and the application of its interpretation of statutes and its own rules and regulations to particular "area rate clauses" within its jurisdiction. Indeed, the contracts' "area rate clause" provision only has meaning because FERC or its predecessor agency has regulated the "area rate" referenced in the clause, and the language of such clauses necessarily track FERC's regulatory language. *See* 18 C.F.R. § 154.93(b-1) (1992);[6] App. 121a. In such instances *Chevron* deference is required.

IV. FERC'S ALLEGED "VACILLATION" DOES NOT PRECLUDE DEFERENCE

NICOR argues alternatively that FERC is not entitled to deference because FERC allegedly "vacillated" by

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[6]This regulation was removed from FERC's regulations. *Removal of Outdated Regulations Pertaining to the Sales of Natural Gas Production*, Order No. 567, III F.E.R.C. Stats. & Regs. (CCH) ¶ 30,999 (1994).

changing its position on rehearing. Br. Opp. at 11, 15-16. NICOR is wrong. The D.C. Circuit has found that the very purpose of statutory rehearing would be thwarted if *Chevron* deference were denied simply because FERC changed its position on reconsideration. *Williams Natural Gas Co. v. FERC*, 3 F.3d 1544, 1550-51 (D.C. Cir. 1993). Importantly, here, FERC set forth in great detail in two thorough opinions its reasons for correcting its original errors. App. 54a-75a, 76a-99a. Under these circumstances, *Chevron* deference should have been accorded.

V. NICOR'S DISCUSSION OF THE SUBSTANTIAL EVIDENCE TEST WITH RESPECT TO THE FIFTH CIRCUIT JUDGMENT IS MISLEADING AND INACCURATE

A. NICOR claims erroneously that the Fifth Circuit adopted an alleged FERC finding that Scarth had not met his burden of proof.[7] To the contrary, in a section headed "Burden of Proof and Procedures," FERC specifically held that it properly placed the burden of proof upon Scarth, and that "[t]he Commission simply found that Scarth met it, for reasons set forth in the order." App. at 82a. Indeed, had FERC actually found, as NICOR now

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[7] *E.g.*, "FERC—not the court of appeals—found the key fact here, namely that petitioner had not met his burden of proof," Br. Opp. at 18; "FERC *itself* determined, both initially and on rehearing . . . that petitioner did not prove by a preponderance of the evidence that the contractual language and extrinsic evidence supported his interpretation," *id.* at 2; "[t]he *only* factual finding that ultimately mattered in this case—and one the agency reaffirmed repeatedly . . . was that petitioner failed to prove his position by a preponderance of the evidence." *Id.* at 16.

argues, that Scarth did not meet his burden of proof, then Scarth, rather than NICOR, would have been the petitioner below.

B. NICOR claims that the Fifth Circuit did not misapply the substantial evidence standard "because it accepted . . . every single one of the agency's factual findings." Br. Opp. at 16. This simply is not true. FERC below properly applied the factual inferences established in Opinion 77. *See* Pet. at 13-20. Rather than accepting such factual findings, the Fifth Circuit invalidated Opinion 77, but without making the requisite finding that FERC's Opinion 77 factual inferences were not based on substantial evidence.[8]

The Fifth Circuit invalidated a number of other factual findings of FERC (without the requisite substantial evidence findings, and therefore did not "accept[] *all* of FERC's factual findings)." Br. Opp. at 2. Thus, the court failed to give conclusive weight, as required by the substantial evidence test, to the FERC findings that (a) NICOR did not object to congressionally-established rates (App. 99a); (b) NICOR's witnesses conceded "there is no evidence that . . . a 'cost-based' limitation" was ever expressed in negotiations (App. 60a, 79a); (c) "the producers

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[8]Indeed, the court acknowledged that in Opinion 77 FERC found that by contract references to the NGA or its "just and reasonable" standard, supplemented by the phrase "or successor statutory authority" or similar words, "the parties commit their contractual destiny to a change in the statutory scheme and give advance acceptance to the outcome of the legislative process." App. at 7a, n.3 (*quoting* Opinion 77). Rather than "accepting" such factual findings, the Fifth Circuit held invalid Opinion 77, but failed to make the requisite substantial evidence findings.

intended to get the highest lawful rate" (App. 91a, n.23; 58a); and (d) NICOR in the contracts *agreed to pay* "a non-cost-based" rate. App. 91a-92a, n.25. The Fifth Circuit's ultimate ruling cannot be harmonized with these factual findings of FERC. *See also* Pet. at 17 n.12.

CONCLUSION

Wherefore Scarth prays that a writ of *certiorari* issue to review the judgment of the Fifth Circuit.

Respectfully submitted,

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